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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-965

WARNER COMPANY, *Appellant*

v.

UNITED STATES OF AMERICA, *Appellee*

AMICUS CURIAE BRIEF OF THE NATIONAL LIME ASSOCIATION IN SUPPORT OF THE PETITION FOR CERTIORARI

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INTEREST OF THE AMICUS CURIAE

The National Lime Association, which has obtained the consent of both the Counsel for the Appellant and the Appellee to file a brief Amicus Curiae in support of the petition for certiorari in this case (*see* Appendix), is a national trade association comprised of approximately 50 companies representing over 85 percent of the United States commercial lime industry

production capacity. A large majority of the companies are integrated miner/manufacturers of lime, which is produced by calcining at high temperatures high quality limestone. Some members also sell crushed and ground limestone to the metallurgical and chemical process industries and for other purposes.

Since most members of the Association are integrated miner/manufacturers in the lime business, they have a direct interest in any determination as to the proper method to be employed by such an entity in determining the allowable percentage depletion on its raw minerals. Moreover, many of the members use the representative field or market price method in determining a constructive gross income from mining for depletion purposes, and would necessarily be directly affected by any decision the Court were to make regarding the proper application of this method.

By this brief, The National Lime Association wishes to aid the Court in understanding the national importance of the issues in this case and the need to clarify for integrated miner/manufacturers in all fields the proper rules to apply in determining the percentage depletion to which they are entitled. The Association also seeks to show this Court that the decision of the Third Circuit Court of Appeals is contrary to the teaching of this Court, and in conflict with numerous other federal circuit court decisions.

STATUTES INVOLVED

This petition for certiorari involves the proper application of Internal Revenue Code sections 611 and 613 (26 U.S.C. § 611 and § 613) and the regulations thereunder.

QUESTION PRESENTED

Whether in determining a representative field or market price for the limestone mined by the petitioner, an integrated miner/manufacturer, in order to determine its gross income from mining for purposes of calculating the percentage depletion to which it is entitled under Internal Revenue Code sections 611 and 613, the Court of Appeals improperly applied Treasury Department regulations in such a manner as to deprive the petitioner of the statutory depletion allowance provided it by Congress.

STATEMENT OF THE CASE

During 1956-1961 (the years in issue), petitioner was in the business of manufacturing and selling lime at Bellefonte, Pennsylvania.[1] Bellefonte is a distinct and separate field of limestone located in Centre County, Pennsylvania. For many years, Pennsylvania has been one of the leading producers of limestone for high calcium uses.

Petitioner mined its own limestone on property adjacent to its manufacturing facilities. Initially, it quarried the limestone; however, around 1921 or 1922 a switch to a comparatively high-cost deep mine shaft (underground method) was required to obtain the necessary high quality of stone required for lime production. This method is also necessarily employed by the petitioner's competitors in the Bellefonte area (National Gypsum Company and Standard Lime and Cement Company). The mined limestone is crushed and then burned, or calcined, producing pebble lime and

[1] Actually, it carried on business at other locations but only the depletion allowable at Bellefonte was in issue.

other lime products which are subsequently refined and sold by the petitioner. Petitioner's integrated Bellefonte lime operations earned a net profit in each of the years in question.

The two largest uses of high quality limestone are the manufacture of lime and fluxstone in producing steel. During the years at issue, a number of steel companies located in the Pittsburgh area purchased large quantities of limestone for the latter purpose. The limestone was extracted primarily in Virginia and West Virginia by the comparatively low-cost open-face quarrying method. The f.o.b. quarry price was $1.76 per net ton or less. Of course, the delivered price was much higher.[2]

In the years in question the three large scale miners in the Bellefonte area, including the petitioner, consumed practically all of their own limestone.[3] However, a relatively minor amount of fluxstone was provided to the steel companies at f.o.b. quarry prices of approximately $1.55-$1.74 per net ton by the two comparatively low-cost open-quarry producers operating in the Bellefonte area (Whiterock Quarries and Valley View Lime Company). The net tons of limestone sold by these quarries averaged 7.3 percent of the net tons of limestone extracted and used by the petitioner, Na-

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[2] The transportation charges from the Virginia Valley to Pittsburgh for the years in issue ranged from approximately $2.04-$2.67 per net ton.

[3] Warner Company sold less than one percent of its output annually. National Gypsum Company sold no fluxing stone or kilnstone during the years in question. Standard Lime and Cement Company did sell approximately 10,000 to 15,000 net tons of fluxstone annually, to steel companies, but these were accommodation sales made because the steel companies purchased other products from Standard.

tional Gypsum and Standard during the years at issue. Not only would the limestone requirements of the petitioner and its two competitors not have been met by the production of these two quarries, but if more limestone could have been mined by these quarries, it could only have been accomplished at a far higher cost per net ton. Additionally, the f.o.b. price of this limestone would have increased significantly in value if the petitioner and its two competitors were to attempt to purchase the stone in arm's-length competition with each other. Furthermore, a higher price than charged to the Pittsburgh market could have been exacted by these quarries due to their proximity to the petitioner and its competitors.

On its tax returns for the years in issue, the petitioner calculated its percentage depletion by the use of the proportionate profits method because of the lack of any representative field or market price in its market upon which it could make a calculation of its constructive income from its mining operations (*see infra,* for a full discussion of these various methods). The Commissioner of the Internal Revenue Service subsequently assessed a deficiency for the years in question based on an application of the representative field or market price method, using a price of $1.70 per net ton f.o.b. quarry. The petitioner paid the deficiency and sued for a refund in the District Court for the Eastern District of Pennsylvania. The District Court found that the petitioner's relevant market was Bellefonte and that since no representative field or market price existed there during the years at issue, the petitioner was entitled to calculate its depletion allowance using the proportionate profits method.

The Court of Appeals for the Third Circuit subsequently reversed the District Court's judgment, holding that the petitioner's relevant market should not be limited to Bellefonte. Without specifying what other markets may be considered relevant, the Court found that sales to the Pittsburgh market from areas outside of Bellefonte (principally from the Virginia Valley) could serve to establish a representative market price. Since these sales were made at $1.76 per net ton f.o.b. quarry, and petitioner's mining costs were in excess of $2.00 per net ton, petitioner therefore would have no gross income from mining and consequently would be entitled to no percentage depletion.

In so finding, the Court held, in what appears to be in conflict with the Supreme Court's decision in *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76 (1960) (*see infra* for a full discussion of this case), that the price which the manufacturing arm of an integrated miner/manufacturer would pay to its mining half, if disintegrated, was irrelevant in determining a representative field or market price. Furthermore, the Court of Appeals refused to make any adjustment to the f.o.b. quarry price from the Virginia Valley for the freight differential between the Virginia Valley to Bellefonte.

ARGUMENT

I. The Petition for Certiorari Should Be Granted Because the Decision of the Court of Appeals With Respect to the Determination of the Constructive Mining Income of an Integrated Miner/Manufacturer for Purposes of Percentage Depletion Is in Conflict With This Court's Decision in United States v. Cannelton Sewer Pipe Company.

Under Internal Revenue Code sections 611 and 613, a taxpayer is provided with a depletion allowance based on a percentage of its gross income from mining. If

the taxpayer sells the mined product, there is usually little problem in ascertaining "gross income from mining". However, where the taxpayer is an integrated miner/manufacturer, the gross income from mining must be constructively determined.

Treasury Regulations (hereinafter Regulations) Section 1.613-4(c)(1) provides that in determining a taxpayer's gross income from mining, if the taxpayer processes the ore or mineral before sale by the application of non-mining processes, or uses it in his operations, gross income from mining shall be computed by use of the representative market or field price of an ore or mineral of a like kind and grade as the taxpayer's ore or mineral after the application of mining processes actually applied, but prior to the application of non-mining processes. If it is impossible to determine a representative market or field price, the gross income from mining shall be computed by use of the proportionate profits method, unless the taxpayer shows that some other method is more appropriate. Regs. Section 1.613-4(d)(1). Thus, in determining gross income from mining for an integrated miner/manufacturer, the first step is to determine if there is a representative field or market price.

The Regulations are not very helpful in defining what a representative price is. They merely state that the objective in computing gross income from mining by the representative market or field price method is to ascertain, on the basis of an analysis of actual competitive sales by the taxpayer or others, the amount which most nearly represents the approximate price for which the taxpayer, in light of market conditions, could have sold his ores or minerals, if prior to the

application of non-mining processes, the taxpayer had sold the quantities and types of ores and minerals to which he applied non-mining processes. Regs. Section 1.613-4(c)(1). Unfortunately, the Regulations do not elaborate on how to determine in what market and to whom the taxpayer should be considered to have sold his minerals in establishing this hypothetical representative price.

This Court has to some extent clarified the type of sales which will establish a representative field or market price, if any exists. In *United States* v. *Cannelton Sewer Pipe Co., supra,* this Court held that in the case of an integrated miner/manufacturer, depletion must be based only on the miner's constructive income from the raw mineral product. Therefore, the Court continued, *"Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication."* 364 U.S. at 89. (Emphasis added.) While the issue in *Cannelton* dealt with the proper cutoff point of the mineral (*i.e.* the point at which the mineral was first commercially marketable and consequently the stage at which the gross income from the mineral, if sold, would represent gross income from mining), the enunciated test applies equally to any determination of a representative field or market price for this first commercially marketable product. That is, the price at which the mining half would sell its minerals to its manufacturing half in an arm's-length transaction, and conversely, the price which the manufacturing half would pay the mining half for its minerals, must necessarily be the representative market price if the integrated miner/manufacturer is to be treated as selling its minerals to itself.

The Circuit Court's decision in this case is the result of its determination that while an integrated miner/manufacturer should be regarded as selling to its manufacturing half, this does not mean that the price which the manufacturing half would pay to the mining half is relevant. Instead, the essential criteria, according to the Third Circuit, should be the price a consumer located elsewhere (Pittsburgh), who was purchasing elsewhere (Virginia Valley) would pay for the raw mineral at Bellefonte; this is not necessarily what the manufacturing half would pay for the comparable mineral. This interpretation of *Cannelton* is wholly unwarranted and in contradiction of the intent of Congress, as expressed in *Cannelton,* to permit integrated miner/manufacturers to take percentage depletion on their constructive gross income from mining operations. Surely treating the mining half as if it were disintegrated and selling to the manufacturing half could not possibly mean that the mining half should be treated as if it were selling to some other consumer. Of course, the price that the manufacturing half would pay the mining half must be based on representative arm's-length sales in the miner/manufacturer's market of like kind and grade minerals, if any such sales have taken place. However, this is not to say that the mandated hypothetical sale must be based on the price *any* consumer would pay for the raw minerals. Under the rationale of *Cannelton,* the mining half should be treated as if it were selling to any other consumer located in the same market as its manufacturing half and with the reasonably identical needs of its manufacturing half, but totally independent of the mining half.

II. The Petition for Certiorari Should Be Granted Because the Decision of the Court of Appeals With Respect to the Determination of the Constructive Mining Income of an Integrated Miner/Manufacturer Is in Conflict With Numerous Federal Circuit Court of Appeals Decisions.

Not only is the Circuit Court's decision contrary to the intent of *Cannelton*, but it is also in direct conflict with decisions of several other federal circuit courts. In *United States* v. *Henderson Clay Products*, 324 F.2d 7 (5th Cir. 1963), the taxpayer, an integrated miner/manufacturer of brick (manufactured from ball clay) had claimed depletion on its mineral income from the clay on the basis of what it claimed to be representative sales of such clay by independent miners at $10.50 per ton. The taxpayer sold its brick for $8.75 per ton. The Fifth Circuit, following *Cannelton*, held that the miner/manufacturer is to be treated as selling the crude mineral to itself insofar as the depletion allowance is concerned, and that while sales of ball clay may have taken place at $10.50 a ton, that price "in no way represents the price which a non-integrated brick manufacturer [the taxpayer's disintegrated manufacturing half] would pay for clay with which to make brick." 324 F.2d at 15. Thus, the price which would be paid in an arm's-length transaction by the manufacturing half of an integrated miner/manufacturer to its mining half was held to be controlling. To the same effect *see Henderson Clay Products* v. *United States*, 377 F.2d 349 (5th Cir. 1967).

Similarly, in *Kaiser Steel Corp.* v. *United States*, 411 F.2d 335 (9th Cir. 1969), the Ninth Circuit Court of Appeals, in attempting to determine a representative market or field price for an integrated miner/manufacturer's iron ore, held that

> [c]onstructive gross mining income is the amount which would have been earned if the mineral manu-

facturer were disintegrated and the raw minerals were sold by its mining division as a separate entity to its manufacturing division, likewise a separate entity. 411 F.2d at 337.

The Court went on to find that while sales into the taxpayer's locale could establish a representative price, these prices must be adjusted to take into account the taxpayer's competitive advantage in operating mines closer to its customers with lesser freight charges than the independent miner selling into its locale. 411 F.2d at 339. This result is an implicit recognition that the representative price for an integrated miner/manufacturer's raw mineral is the price that its manufacturing half would pay for the mineral, if disintegrated. (*See infra* for a full discussion of this case.)

III. The Petition for Certiorari Should Be Granted Because the Circuit Court's Decision With Respect to the Adjustment for Freight Differentials Is in Conflict With the Ninth Circuit Court of Appeals Decision in Kaiser Steel Corp. v. United States.

In *Kaiser Steel Corporation* v. *United States, supra,* the taxpayer was an integrated miner/manufacturer who mined iron ore which it then consumed in its own steel factories. At that time there was only one independent iron ore miner on the West Coast, and he was located in Utah (the taxpayer was located in California). The independent miner sold substantial amounts of iron ore to the taxpayer and others on an f.o.b. mine basis. While holding that these sales into the taxpayer's *market area* would be evidence of a representative price in the area, the Ninth Circuit held that the f.o.b. price of the sales would have to be adjusted for the freight differential from the independent

operator's mine to the taxpayer's mines.[4] The Court stated its rationale on this key issue as follows:

> "In constructing Kaiser's gross mining income, we must assume that both Kaiser and Utah Construction [the independent miner] are independent miners freely competing with one another for the customers in their marketing area. Since those customers are both in California, . . . Kaiser the miner has a competitive advantage in operating mines closer to the customers with lesser freight charges than Utah Construction has to pay.[5]

That the Court's reasoning is sound is a matter of common sense. Also, it is significant that the same line of reasoning is reflected in the instant case in the statement made by Youngstown Sheet and Tube Steel Company. *See* District Court Joint Exhibit No. 1-CC. Youngstown testified that it purchased limestone at a higher f.o.b. mine price ($2.26 per net ton in 1961) from Carbon Limestone Company and Bessemer Cement Company than was otherwise charged by other miners because Carbon and Bessemer were located nearer to it, thus making the delivered price (including transportation charges) less than from the other miners. The expert testimony at trial similarly established that the only relevant price to a purchaser is the delivered price.

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[4] The taxpayer also mined coking coal, but in Utah, and then shipped this coal to its California factories. The Court did not adjust the f.o.b. price of coking coal sales to the taxpayer's California factories from the independent miner since the evidence showed that the freight rates were the same from the taxpayer's coal mines to its factories as from the independent coal miner to the taxpayer's factories.

[5] *See Kaiser, supra*, at 339.

The Third Circuit found *Kaiser* irrelevant in the petitioner's situation for several reasons. First, the Court did not consider the petitioner's marketing area to be limited to Bellefonte. However, as discussed *supra*, this itself is in direct conflict with *Kaiser*, which limited the integrated miner/manufacturer's market to its consumption area.[6]

Secondly, the Third Circuit found that *Kaiser* was not apposite since it dealt with an integrated miner/manufacturer having its mining and manufacturing facilities geographically separated. Unfortunately, the Court seems to have missed the whole point of *Kaiser*. Under the rationale of *Kaiser*, it is irrelevant whether a miner/manufacturer has all of its operations in one place or if the mining and manufacturing halves are separated. The only relevant fact is whether the mining half of the integrated miner/manufacturer is nearer to its manufacturing operations than the independent miner. If so (as was the situation in *Kaiser* and as is the instant case), a freight differential exists and should be taken into account in determining a representative field or market price.[7]

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[6] *See Kaiser, supra*, at 338.

[7] In fact, this Court in *Cannelton, supra*, in determining that there was a market for raw clay, noted that such clay was being sold in an area of Indiana, some distance from the taxpayer's facilities, for $1.60 to $1.90 per ton, and that transportation costs from that area to the taxpayer's operation ran from $4.58 to $5.50 per ton. Thus, the Court implicitly recognized the need to take freight differentials into account, although admittedly "representative price" was not an issue before the Court. *See Cannelton, supra*, at 80. Freight and location differentials, while unimportant in a determination of what is a "marketable product" are highly relevant and indeed critical in any determination of the appropriate field or market and the representative price, if any, to be derived therefrom.

IV. The Petition for Certiorari Should Be Granted Because of the Necessity for the Supreme Court To Answer an Important Unsettled Federal Tax Question—What Is the Proper Method of Determining a Representative Field or Market Price for Purposes of Computing Percentage Depletion Under Sections 611 and 613 of the Internal Revenue Code?

From the above discussion, it quickly becomes apparent that the federal tax law is in a state of confusion with respect to the determination of the percentage depletion to which an integrated miner/manufacturer is entitled under sections 611 and 613 of the Internal Revenue Code. While this Court has provided guidelines in *Cannelton, supra,* for determining when the mining process ends and the manufacturing process starts, it did not specifically deal with how to value the mineral for purposes of determining the integrated miner/manufacturer's constructive income from its mining operations. Some guidance was provided to the extent that it is clear that the value of the mineral is to be determined as if the taxpayer was disintegrated and sold to itself. However, the unanswered question is what sales are to be relied upon in calculating the price at which a disintegrated miner would sell to its manufacturing half. In this respect various courts have reached different conclusions, some basing the price on sales from the taxpayer's locale to other areas,[8] some on sales from outside the taxpayer's locale into that area,[9] and in this case, on sales made outside the taxpayer's locale to other areas outside the locale.

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[8] *See Hugoton Production Co.* v. *United States,* 315 F.2d 868, 877 (Ct. Cl. 1963) and *Phillips Petroleum* v. *Bynum,* 155 F.2d 196, 197-8, 201 (5th Cir. 1946).

[9] *See Kaiser Steel Corp.* v. *United States, supra.*

Additionally, it is also necessary to determine what are representative sales in that "market or field".

This determination of a representative field or market price is critical to a proper calculation of the income of an integrated miner/manufacturer. If not calculated properly, the miner/manufacturer will either pay too much or too little taxes. Since a large majority of the members of the National Lime Association are integrated miner/manufacturers and many are currently using the representative field or market price method to determine gross income from mining (and others may use this method at some time in the future), the Association has a direct interest in this issue. Furthermore, numerous other integrated miner/manufacturers of a variety of minerals use this method for determining their gross income from mining.

A decision by the Court on the proper application of this method would go far toward eliminating current and potential future conflicts between taxpayers and the Internal Revenue Service and would consequently ease the administration of the tax system, as well as making it more uniform and equitable.

CONCLUSION

In view of the conflicting decisions of this Court and Federal Circuit Courts of Appeals with the decision in this case, as well as the important unsettled federal tax question presented by this case, the Court should grant the petition for certiorari.

Respectfully submitted,

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APPENDIX

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January 9, 1975

Jay Glassman, Esquire
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Washington, D. C. 20006

Re: Warner Company v. United States
Third Circuit Court of Appeals,
Nos. 73-1722 and 73-1723

Dear Mr. Glassman:

You have advised us that the National Lime Association desires to file an amicus brief in support of the Warner Company Petition For Certiorari in the above case. This letter is to confirm that Warner Company consents to the filing of such an amicus curiae brief by you on behalf of the National Lime Association.

Very truly yours,

/s/ JULES I. WHITMAN
Jules I. Whitman

JIW: bf

cc: Robert H. Bork
Solicitor General of the
United States

January 7, 1975

Jay W. Glasmann, Esquire
Ivins, Phillips & Barker
1700 Pennsylvania Avenue, N.W.
Washington, D. C. 20006

Re: *Warner Company* v. *United States of America*

Dear Mr. Glasmann:

In accordance with your request of January 2, 1975, I hereby consent to your filing of an *amicus curiae* brief on behalf of the National Lime Association in support of Warner Company's petition for a writ of certiorari in the above-captioned case.

Sincerely yours,

ROBERT H. BORK
Solicitor General